U.S. Senate Committee on Banking, Housing, and Urban Affairs

U.S. SENATOR RICHARD C. SHELBY, AL, RANKING MEMBER

EMBARGOED UNTIL BEGINNING OF HEARING

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OPENING STATEMENT OF SENATOR RICHARD C. SHELBY

"Turmoil in U.S. Credit Markets: Examining Proposals to Mitigate Foreclosures and Restore Liquidity to the Mortgage Markets."

4-10-08

"Thank you, Mr. Chairman."

"Our hearing this morning provides an opportunity to examine various proposals aimed at resolving problems facing homeowners and financial institutions. It is now clear that problems in the mortgage market have not been contained and that these difficulties have affected the overall economy. Each day we hear more troubling numbers associated with foreclosures and declining home values. We also see signs of an economic slowdown, if not a recession."

"When presented with economic challenges, all too often we turn to familiar policy options, usually without examining whether today's circumstances differ in any way from the past. Since many have advocated that the depression-era Homeowners Loan Corporation be resurrected to solve today's mortgage problems, I believe that it is wise to start with a bit of history and perspective."

"The original program was created when the Home Owners Loan Act became law. This is the same act that created the Federal Home Loan Bank system. At that time, the secondary mortgage market did not exist. In fact, almost three-fourths of the counties in this country had no mortgage origination market at all – due in large part to the failure of local banks and savings institutions. We have not experienced anything approaching the bank failure rate of the early 20th Century."

"Today's mortgage market is clearly much different. While credit has tightened for some products and in some markets, we continue to have a functioning primary and secondary mortgage market. While unemployment has risen to 5.1 percent, this stands well below that of the high double-digit rates of the Great Depression. This should be a significant factor in our examination. How it is that so many people who have not suffered job or income loss now find themselves in a position of not being able to afford their current mortgage payments? Clearly, current market and economic conditions are significantly different from those we experienced in the Great Depression."

“I believe part of our current dilemma is rooted in the so called ‘lend-to-distribute’ model where a non-bank originates a loan with the anticipation that it will be sold to the secondary market for a fee. This model allowed lenders to do very little oversight of their underwriting criteria. It also provided an incentive for unscrupulous actors to lie about income, job history, or the value of the home. Securitizers had very little incentive to ensure that the loans were properly underwritten because they held these assets only long enough to package them up and sell them in the form of mortgage backed securities to the broader market. The final part of this process was the willingness of investors to buy up the securities with very little due diligence so long as a credit rating agency was willing to say that these securities were ‘investment grade’. In turn, the rating agencies received a hefty fee for each deal.”

“In hindsight, it is not difficult to see why this was a recipe for disaster. It was a market wide conspiracy of willful ignorance and everyone was happy to be in the dark so long as the money kept rolling in. Like all good things, it came to an end and now the question is what, if anything, should we do about it?”

“In an effort to help able borrowers caught by rate resets, many private market participants including consumer advocates, servicers and investor groups came together to form the HOPE NOW alliance. This group created a streamlined process to identify ways to help borrowers with varying degrees of credit and home equity to reduce their monthly payments. Options include refinancing, loan modifications, or some form of forbearance. This effort has met with mixed reviews mainly because borrowers either refuse to contact their lenders, or refuse to respond to a lender’s attempt to contact them. Congress has provided hundreds of millions of dollars for counseling in the hope that it can facilitate lender-borrower communication. Whether it does remains to be seen.”

“In addition to the efforts of HOPE NOW, many individual servicers are reaching out to borrowers to explain the options available to them. Many servicers have voluntarily begun to write down the principal amounts of individual loans for borrowers. The Federal Housing Administration also has offered individuals facing foreclosure, through the FHA Secure program, the ability to refinance out of adjustable rate mortgages. The FHA currently is considering expanding that program to reach additional borrowers.”

“As we consider whether to take any further legislative steps, I believe we must answer several threshold questions:

First, how many borrowers will this legislation actually help?

Who are the borrowers or other entities that each proposal would benefit?

If the most creditworthy borrowers are able to refinance their loans under existing initiatives, then would the government now be stepping in to help those with poor credit who are significantly underwater?

Would the proposal assist the homeowner who knowingly purchased more home than they could afford in hopes of riding the home appreciation wave? Keep in mind that many borrowers have refinanced their homes several times and extracted the equity.

Would they qualify for taxpayer backed assistance?

What about the prudent individual who decided to save for a downpayment while renting?

Should they be made to pay for the mistakes of delinquent borrowers or speculators?

What kind of signal would this send to those who did the right thing by waiting and saving their money?

How much will this truly cost the taxpayer?

Once we allow the seriously delinquent borrower to refinance into an FHA loan what prevents them from defaulting again?"

"Having raised these questions, we should proceed with caution so as not to make or exacerbate the mistakes that have brought us to this point. We should not legislate without greater clarity with respect to the consequences to both the market and most importantly to the taxpayers of this country. I hope that our hearing today and any upcoming hearings provide this Committee with answers to these and many other important questions."

"Thank you, Mr. Chairman."